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SUBJECT: The Japan Economic Scope - June 7, 2007 - Part 2

Sensitive but unclassified. Please protect accordingly.

¶1. (U) This cable contains part two of the Japan Economic Scope from June 7,
¶2007.

2.(SBU) Table of Contents

¶3. (U) Northern Japan's Biotech Crops Regulatory Regime: an In-depth Look
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In 2006, Japan's northernmost island of Hokkaido became the first prefecture in the country to implement strict local regulations governing the open-air cultivation of biotech crops.

Drafted in the aftermath of several national food safety scandals involving Hokkaido products, the new regulations were intended to protect local crops from criticism over biotech crop cross-pollination concerns.

The regulations, however, also effectively ended serious attempts at biotech farming in Hokkaido by making it prohibitively difficult for local farmers to grow biotech crops.

Recently, the Hokkaido prefectural government hosted a series of public forums to seek input on whether the biotech regulations should be revised. Attendees did not reach a consensus, but it was clear at the meetings that local anxiety about biotech crops remains high. This anxiety will not dissipate as long as the

Japanese public remains confused by the mixed signals the Government of Japan sends on biotech.

As local governments like Hokkaido decide to address public concerns themselves, it is becoming even more challenging for U.S. companies to sell biotech products in Japan. For more information, please see Sapporo 0029. (Sapporo: Ian Hillman/Yumi Baba)

¶4. (SBU) KIAC Chairman Welcomes Asian Open Skies Policy of GOJ

At a lecture in Osaka on May 17, KIAC Chairman Hajime Miyamoto welcomed the recent Asian Open Skies policy floated by PM Abe's Asian Gateway council. The policy would open up regional airports like KIX and Centrair to open skies-type arrangements with Asian counterparts on a reciprocal basis.

Miyamoto noted at the International Executive Seminar of M.I.E. Corporation that 36 percent of all KIX passenger flights and 50 percent of its cargo business was with China, with the KIX air cargo business continuing to expand in Asia. Miyamoto expected further growth in KIX's Asian business once its second runway opens in August.

KIAC continues to grouse about the 1.2 trillion yen debt it was saddled with over the expensive land reclamation and island construction dating back to when the airport was run by the central government.

Chairman Miyamoto said that KIAC Vice President Hirano has been actively lobbying politicians in Tokyo to shift part of the company's 1.1 trillion yen in debt back to the GOJ. Miyamoto claimed that KIX could not compete with Narita due to such costs.

The chairman asked the GOJ for support in the basic development and maintenance of the IT infrastructure at Japanese airports. Chairman Miyamoto said that he and President Atsushi Murayama managed to turn around the corporate culture at the airport from the fuzzy world of amakudari collusion with government bureaucrats to a leaner customer service-oriented private sector ethos.

One airport manager commented that the Abe Administration's Asian Open Skies proposal would help meet the rising demand for even more flights to China. (Osaka-Kobe: Phil Cummings/Naomi Shibui)

¶5. (SBU) KIX Criticizes JAL for Cancelling LA Routes

Kansai International Airport Company (KIAC) Vice President Tadakuni Hirano criticized JAL for cancelling the KIX route to Los Angeles and for further disrupting KIX's international business by offering feeder flights to Narita from nearby rival Itami Airport, which is not supposed to compete for international traffic, at the second meeting of the KIX Study Group. Hirano called on JAL to restore its U.S. routes from KIX.

JAL refused to offer more than vague assurances it would resume service someday from KIX.

The atmosphere of the meeting was unusual in the open quarreling between the airport and the Japanese carrier.

ConGen is polling ACCJ Kansai members on their use of the airport for travel to the United States for future discussion.

For further details on the meeting, see the attached readout. (Osaka-Kobe: Phil Cummings/Naomi Shibui)

¶6. (SBU) NHTSA Administrator Visit on Auto Safety and Fuel Efficiency
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Nicole Nason, National Highway Transportation Safety Administration Administrator (NHTSA), visited Japan on May 28-31

to meet with Japanese officials at the Ministry of Land Infrastructure and Transportation (MLIT) and Japanese automakers to discuss trends in automobile safety and fuel efficiency as well as to confirm the status of bilateral cooperation on Global Technical Regulations WP.29.

Nason was particularly interested in the latest crash avoidance technologies that, if introduced, could lead to a reduction in the annual number of traffic fatalities and injuries in the United States.

Nason along with her Chief of Staff David Kelly, Senior Associate Administrator for Vehicle Safety Ronald Medford, and Chief of International Vehicle and Harmonization Ezana Wondimneh met with Kazuyoshi Matsumoto, Director General of the Engineering Safety Department in the Road Transport Bureau at MLIT, and made site visits to Nissan, Toyota and Honda safety research centers. During the meeting with DDG Matsumoto, he emphasized Japan also has a goal to reduce the number of traffic accident fatalities.

Prime Minister Koizumi had urged creating a society with no traffic fatalities and as a first step wished to have less than 5,500 fatalities by 2010. In 2006, there were some 6,400 traffic accident fatalities, and MLIT is seeking to cut this number by another 750 by 2010.

In Japan, since 30 percent of fatalities involve pedestrians and there are an increasing number of elderly people, avoiding accidents with pedestrians and the elderly is a policy focus.

DDG Matsumoto outlined Japan's desire to improve the fuel efficiency of vehicles due to Japan's scarce energy resources and worries about global warming.

He noted that Japan set standards for increasing the fuel efficiency of gas-powered cars by 20 percent and diesels by 12 percent by 2015. Since this is hard to do through regulations, Japan is using tax incentives to encourage consumers to buy more fuel efficient vehicles.

He acknowledged the widening use of bio-fuels will be difficult in Japan. (ECON: Josh Handler)

¶7. (U) Kyushu One Step Closer to "1.5 million Car Production Project"

On May 31, Toyota Kyushu, a wholly owned subsidiary of Toyota Motor, announced plans to invest 16 billion yen ($134 million) in a new plant for hybrid vehicle parts outside of Kitakyushu, Fukuoka Prefecture.

The "Kokura Plant" will create 150 new jobs, and be Toyota's third Fukuoka Prefecture production base after the Miyata Plant for finished cars and the Kanda Plant for engine production. Operations are scheduled to begin in the summer of 2008, and the Miyata and Kanda plants' existing hybrid car parts production will be consolidated.

Fukuoka Governor Aso, Committee Chairman for the Promotion of 1.5 Million Automobiles Production in Northern Kyushu, told the media that the committee hopes the region can produce 1.5 million units by JFY08 and expand the local content of auto parts from the current 50 percent to 70 percent by JFY09. In JFY06, Toyota (Fukuoka), Nissan (Fukuoka), Daihatsu (Oita) together produced 1.01 million cars, mainly for export to North America. Their possible plans for continued expansion will play a key role in determining whether the region's total output capacity reaches the desired 1.5 million unit goal, which would make Northern Kyushu's production level second only to that in the Nagoya area. (Fukuoka: Yuko Nagatomo/Jim Crow)

¶8. (U) Central Japan Growth Tops Out?

Recent strong growth in the Central Japan region centered on Nagoya may have hit a plateau. In late May, the Bank of Japan revised its evaluation of the Tokai region economy downward for the first time in 30 months. The BOJ now characterizes Central Japan as "expanding moderately," down from "expanding."

BOJ Nagoya Chief Takashi Oyama cited falling U.S. demand for autos and a shortage of labor and land for plant construction in Nagoya's Aichi prefecture as major factors in the slowdown of growth. Oyama, however, described Central Japan's recent growth rate as excessive, and said the region's current slower pace of growth is actually a healthy trend since it reduces the risk of overheating and will be sustainable for a longer period.

Meanwhile, reflecting the BOJ's assessment on the Aichi land shortage, METI's Chubu Bureau reported that factory construction in Gifu prefecture, adjacent to Aichi, increased 12 percent year-on-year, largely on the back of Aichi-based firms expanding into Gifu.

Separately, the Asahi Shimbun reported May 31 that due to uncertain global demand, the total capital investment of Nagoya-area Yamazaki Mazak, Mori Seiki, and Okuma, all among the world's top ten machine tool makers, will total 27 billion yen ($225 million) in FY07, down nearly 30 percent from FY06. (Nagoya: Dan Rochman)

¶9. (U) Kansai Companies Show Record Profits

A majority of the listed companies in the Kansai region exceeded profit records for 2006, according to their May financial submissions as summarized in the local press.

These companies experienced an average of 9.4 percent growth in sales and eight percent in profits over the previous year. In particular, digital appliance, auto, and steel exports were strong.

On the negative side, housing and retail lagged and domestic consumption remained problematic for the Kansai economy.
A researcher of Mitsubishi UFJ Research and Consulting commented that capital investment is increasing in some sectors, but some exporters have been more reluctant to invest, citing fears of fluctuations in overseas markets. The researcher feels this

cautious attitude will continue despite the overall boom. (Osaka-Kobe: Phil Cummings/Naomi Shibui)

¶10. (U) Rising Price of Raw Materials Hurting SMEs

In spite of the GDP growth in the first quarter of 2007, bankruptcies in the Kansai region increased, and consumption in retail stores fell.

According to the recent study by Tokyo Shoko Research, the number of bankruptcies with more than 10 million yen in the Kansai region accounted for over a quarter of all domestic bankruptcies, almost triple the rate of central Japan around Nagoya. Department store consumption in the three major cities of the region fell slightly.

A senior manager in the Kansai Branch of Tokyo Shoko Research said that 80 percent of bankruptcies in the Kansai were by SMEs, mostly in construction, IT, and food businesses. Rising prices in imported foodstuffs such as edible oil, oranges, and soybeans are hurting Japanese food businesses. He added that the recent economic growth in Japan and the Kansai region has not spread to SMEs yet. (Osaka-Kobe: Phil Cummings/Naomi Shibui)

¶11. (U) Osaka Wins Large Greenfield Investment in Giant LCD TV Displays

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Japan's number two LCD TV display manufacturer Sharp chose a former steel plant site in Sakai City, Osaka Prefecture, over a candidate in neighboring Hyogo Prefecture, a rare investment victory for the embattled prefecture.

Sharp will pour 500 billion yen ($4 billion) in capital investment into the site in order to compete globally with Samsung and Sony, the top world producers of the technology. Sharp commanded 11.5 percent of world market share in 2006. The new plant in Sakai is scheduled to open in 2008 and produce 30,000 -- 60,000 panels per month. Although Sharp ramped up LCD production in its main plant in Kameyama, Mie Prefecture, it is still unable to meet demand for its 40" flat TVs.

Business sources credit Osaka Prefecture's landing of the deal on its five to twenty percent subsidy for high tech investments, and Sakai's convenient transportation links. Sakai is also kicking in a 20 percent break on property tax for the first 10 years. Akio Nomura, Chairman of Osaka Chamber of Commerce and Industry had high expectations that the new plant would offer new jobs and stimulate related businesses. An official from the prefecture expected the plant to also increase KIX and Osaka port utilization. (Osaka-Kobe: Phil Cummings/Naomi Shibui)

¶12. (U) USJ New Investment in 2008

The Universal Studios Japan (USJ) President & CEO Glenn Gumpel announced the amusement park will make a three billion yen ($25 million) investment in new attractions. The company estimates a 0.3 percent increase in visitors due to new attractions opened in ¶2007. USJ's strategy of large capital investment appears to be paying off as the company will issue dividends for the first time since opening in 2001.

According to a manager of USJ Technical Division, after the fatal roller coaster accident at nearby Expo Land in Osaka on May 5, USJ's new roller coaster was inspected by Osaka City. There were no irregularities. USJ was happy to report that it has yet to see a drop in attendance due to the heightened concern about coaster safety. (Osaka-Kobe: Phil Cummings/Naomi Shibui)

¶13. (U) Kyushu Bank Consolidation: Largest Regional Financial Group is Born
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On May 24, Fukuoka Financial Group (FFG) announced it will buy Shinwa Bank, the banking arm of Sasebo, Nagasaki prefecture-based Kyushu-Shinwa Holdings Inc. (KSH), by October 2007.

The addition of Shinwa Bank increases FFG's combined assets to 11.7 trillion yen ($97.5 billion), enabling it to surpass the

Bank of Yokohama as Japan's largest regional financial group. The local financial community expects the merger to help increase financial and economic stability in the region.
FFG, however, will continue to lag behind the Bank of Yokohama in profitability.

KSH will disband after selling its remaining shares of Shinwa Bank and a credit card subsidiary for 76 billion yen ($633 million). KSH president Takashige Araki attributed KSH's dissolution to its inability to recover in the near future due to the continued depressed state of Nagasaki's economy.

FFG was set up on April 2, 2007, following the business integration of Fukuoka Bank and Kumamoto-based Kumamoto Family Bank.

Local financial observers anticipate more regional realignments across prefectural borders in the future as a result of continuing GOJ pressure for regional bank consolidation and growing competition with major banks and Japan's postal savings

bank, which is scheduled to open for services in October 2007.
(Fukuoka: Yuko Nagatomo/Jim Crow)

¶14. (U) Tot Hit with $2 million Tax Bill

The Nagoya Regional Taxation Bureau this week ordered a U.S.-citizen pre-schooler to pay 250 million yen ($2 million) in back taxes and penalties.

The tyke tycoon, both of whose parents are Japanese, is the grandson of the Chairman of Chuoh Publishing Co., who, on the recommendation of financial advisors, transferred to him about 500 million yen ($4 million) worth of U.S. Treasury bonds shortly after his birth in Los Angeles in 2003.

Since the moppet millionaire and his parents moved back to Nagoya in 2004, the Tax Bureau determined the transaction is taxable in Japan and assessed both fees and fines. The child's parents are appealing the ruling. (Nagoya: Dan Rochman)

¶15. (U) Correction

In the May 31 edition, please note in the article on METI selling shares of Japex, the correct conversion from 80 billion yen is $658 million, not $658,000. (Econ: Eriko Marks)
SCHIEFFER